

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
PHILLIP F. AND JUDY KAUFFMAN GOLDSTEIN	:	DETERMINATION
	:	DTA NO. 819377
for Redetermination of a Deficiency or for Refund of	:	
New York State and New York City Personal Income	:	
Taxes under Article 22 of the Tax Law and the New	:	
York City Administrative Code for the Year 1997.	:	

Petitioners, Phillip F. and Judy Kauffman Goldstein, 60 Heritage Drive, Pleasantville, New York 10570, filed a petition for redetermination of a deficiency or for refund of New York State and New York City personal income taxes under Article 22 of the Tax Law and the New York City Administrative Code for the year 1997.

A hearing was held before Frank W. Barrie, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on December 1, 2003 at 10:30 A.M., with all briefs to be submitted by March 8, 2004, which date began the six-month period for the issuance of this determination. Petitioner Phillip F. Goldstein appeared *pro se* and on behalf of his wife. The Division of Taxation appeared by Mark F. Volk, Esq. (Jennifer L. Hink, Esq., of counsel).

ISSUE

Whether the Division of Taxation properly asserted penalties for both late payment and late filing for 1997.

FINDINGS OF FACT

1. In a prior career, petitioner, Phillip F. Goldstein, was an engineer employed by the City of New York. In the early 1990s, Mr. Goldstein shifted gears and became a successful investment advisor and investor. His success was reflected in petitioners' tax return for the year at issue. For 1997, petitioners reported New York adjusted gross income of \$2,116,557.00 calculated as follows:

Items of income and adjustments	Amount
Mr. Goldstein's wages from Kimball & Winthrop, an investment firm	\$ 52,000.00
Taxable interest income	19,691.00
Dividend income	603,932.00
Business income on gross receipts or sales of \$495,607.00 from Mr. Goldstein's business or profession of investment advisor	143,726.00
Capital gain	1,542,622.00
Schedule E supplemental income and loss including a loss from Kimball & Winthrop, an S Corporation, of -239,214.00.	-243,395.00
Federal adjustment to income: deduction for self-employment tax	-2,756.00
Federal adjusted gross income	\$2,115,820.00
New York addition for interest income on state and local bonds and obligation not those of NY State or its local governments	1,916.00
New York subtraction for interest income on U.S. government bonds	-1,179.00
New York adjusted gross income	\$2,116,557.00

2. Petitioners filed their 1997 resident income tax return (form IT-201) nearly three years late on April 12, 2001. This return was a complex filing which included schedules listing 103 transactions involving short-term capital gains and losses and 46 transactions involving long-

term capital gains and losses as well as details for the various other items of income and loss noted in Finding of Fact “1”.

3. The Division of Taxation (“Division”) issued a Notice and Demand for Payment of Tax Due, dated October 19, 2001, against petitioners, asserting interest of \$9,478.41, plus penalty of \$14,200.75, due to petitioners’ late payment of their income tax liability for 1997. Interest and penalty asserted due were calculated based upon late payments of \$37,869.00 computed as follows:

Tax per taxpayer ¹	\$195,522.00
Timely payments/credits	157,653.00
Late payments	37,869.00

Penalty for late filing at 4½ % per month with a maximum of 22½ %² and penalty for late payment at ½ % per month with a maximum of 25 % were applied to calculate the penalty asserted due, and interest was calculated due for late payment at the applicable statutory rate.

Petitioners made payment on this Notice and Demand, and filed a Claim for Credit or Refund of Personal Income Tax dated April 15, 2002 in which they seek a refund of such payment.

4. In light of the complexity of petitioners’ tax returns, as a consequence of Mr. Goldstein’s endeavors as an investor and investment advisor, petitioners have consistently filed late income tax returns with both the Internal Revenue Service and New York State. In lieu of the timely filing of tax returns, Mr. Goldstein has taken care to make estimated tax payments that he believes will be in excess of any ultimate income tax liability so as to avoid the imposition of

¹ The Division accepted the amount of tax reported due by petitioners.

² As noted in the Conclusions of Law, pursuant to Tax Law § 685(a)(1)(A) the maximum penalty for late filing is 25%, not 22½%. There is no explanation for this disparity in the record.

interest and penalties when petitioners finally get around to submitting their returns. Except for the year at issue, this strategy has so far been successful although, as of the date of the hearing in this matter, petitioners had not yet filed income tax returns for 2000, 2001, 2002 or 2003.

5. For 1997, petitioners made a late payment of taxes of \$37,869.00 when they filed their 1997 tax return nearly three years late on April 12, 2001. Petitioners blame the Division of Taxation for their underpayment contending it was a consequence of the Division's refusal to apply their overpayment of income tax of \$40,864.22, as requested by them on their 1996 income tax return, to their 1997 estimated tax. Petitioners' 1996 return was not filed until January 20, 1999, almost two years late, and instead of applying this overpayment of \$40,864.22 to petitioner's 1997 estimated tax account, the Division issued a refund of \$40,864.22 plus interest of \$568.11.³ The Division maintained that the time had expired for petitioners to request that their 1996 refund be applied to their 1997 estimated tax account. Petitioners cashed the refund check.

6. The Internal Revenue Service has credited the overpayment of taxes by petitioners in one year to the succeeding year regardless of the late filing of their tax returns. On the New York income tax return, there is nothing to indicate a time limitation on a taxpayer requesting that an overpayment be applied to the succeeding tax year. For example, line 68 of petitioners' 1997 tax return provides: "Estimated tax only: Amount of line 66 [the amount overpaid] that you want applied to your 1998 estimated tax."

³ Pursuant to Tax Law § 688(a)(3), interest on an overpayment begins to accrue only after a late return is filed which explains this limited amount of interest. Petitioners point out that the Division had interest-free use of their overpayment of \$40,864.22 for more than two years.

SUMMARY OF THE PARTIES' POSITIONS

7. Petitioners do not contest the fact that they untimely filed their 1997 New York income tax return. Rather, they contend that no penalties may be imposed on them for late filing and payment because the Division's "*refusal to apply the [petitioners] overpayment for 1996 to their 1997 estimated tax as instructed was arbitrary*" (emphasis in original). Petitioners maintain that under Tax Law § 686(e) they had the right, on their 1996 tax return filed almost two years late, to claim as a credit against estimated tax for the succeeding year of 1997, their overpayment of income tax for 1996. They contend that there is no statutory or regulatory limitation on this statutory right. They distinguish between an estimated tax payment and an overpayment from a prior year to be credited to an estimated tax account. Petitioners assert that they kept the refund check for overpayment of their 1996 income tax because they were unaware of an unwritten policy of the Division to accept the return of an unwanted refund check and apply it to a taxpayer's estimated tax account for the following year. In sum, petitioners maintain that their late payment of 1997 taxes was not willful or negligent but the result of the Division's refusal to apply the refund due to them of 1996 taxes to their 1997 estimated tax account, as they requested on their 1996 New York personal income tax return.

8. The Division agrees that pursuant to Tax Law § 686(e), an overpayment of income tax for one year may be credited against the estimated income tax for the next year. However, the Division contends that petitioners did not have an overpayment of estimated tax for 1996 until January 20, 1999 when they finally filed their 1996 income tax return. At such late date, according to the Division, petitioners "were already untimely in their payment of estimated tax for 1997 [since the last installment of estimated tax for 1997 was due on January 15, 1998]."

The Division points out that the tax regulations set forth specific due dates for an installment

payment of estimated tax and that the Division has authority under Tax Law § 685 to assess penalties on any inadequate installment payment of estimated tax. Estimated tax payments, according to the Division, must be made in a timely manner by taxpayers. The last time to have wages withheld for 1997 was December 31, 1997, and the last time to make estimated tax payment for 1997 was January 15, 1998. Consequently, the Division asserts that petitioners' estimated tax account for 1997 was closed as of January 15, 1998. Therefore, the Division maintains that it properly issued a refund check for petitioners' overpayment of 1996 income tax and emphasizes that petitioners cashed this check. In sum, the Division contends that penalties were properly asserted against petitioners because "they failed to timely make payments into their 1997 estimated tax account" (tr., p. 23).

CONCLUSIONS OF LAW

A. Pursuant to Tax Law § 651, a New York personal income tax return "*shall* be made and filed" on or before April 15th following the close of the taxable year (emphasis added).

B. Pursuant to Tax Law § 685(a)(1) and (2), penalties for late filing and late payment, respectively, are imposed based upon a calculation whereby a certain percentage is applied to any underpayment of tax as shown on the late-filed return. For late filing, a penalty of five percent of the amount of tax due is imposed "if the failure is for not more than one month, with an additional five percent for each additional month or fraction thereof during which such failure continues, not exceeding twenty-five percent in the aggregate" (Tax Law § 685[a][1][A]). For late payment, a penalty is imposed of "one-half of one percent of the amount [shown due on the return] if the failure is not for more than one month, with an additional one-half of one percent for each additional month or fraction thereof during which such failure continues, not exceeding twenty-five percent in the aggregate" (Tax Law § 685[a][2]). If no underpayment of tax is

shown, then a mere penalty of \$100.00 may be imposed pursuant to Tax Law § 685(a)(1)(B) if the return is filed more than 60 days late. Consequently, the failure to file a timely return results in no meaningful consequence unless tax is *due and owing* as of the April 15th deadline noted in Conclusion of Law “A”.

C. Tax Law § 685(a)(1) and (2) further provides that penalties for late filing and late payment may be abated if a taxpayer is able to show that the failure to timely file and pay was due to reasonable cause and not due to willful neglect. However, the Tax Appeals Tribunal has noted that, in the first instance, the imposition of penalty is mandatory and not discretionary on the part of the Division:

By first requiring the imposition of penalties (rather than merely allowing them at the Commissioner’s discretion), the Legislature evidenced its intent that filing returns and paying tax according to a particular timetable be treated as a largely unavoidable obligation [citation omitted] (*Matter of MCI Telecommunications Corp.*, Tax Appeals Tribunal, January 16, 1992, *confirmed* 193 AD2d 978, 598 NYS2d 360).

Consequently, given the fact that petitioners failed to timely file a return and pay their 1997 New York income tax, penalties for late filing and late payment were, in the first instance, properly imposed on petitioners. The analysis therefore shifts to whether petitioners have established that their failure to timely file and pay was due to reasonable cause and not due to willful neglect.

D. The Division in its income tax regulations has promulgated the following catchall provision concerning what constitutes “reasonable cause”:

Any other cause for delinquency which would appear to a person of ordinary prudence and intelligence as a reasonable cause for delay and which clearly indicates an absence of willful neglect may be determined to be reasonable cause. Ignorance of the law, however, will not be considered as a basis for reasonable cause (20 NYCRR former 107.6[d][4]).

E. Tax Law § 685(c)(1) sets forth specific due dates for the payment of estimated tax installments as follows:

There shall be four required installments for each taxable year, due on April fifteenth, June fifteenth and September fifteenth of such taxable year and on January fifteenth of the following taxable year.

F. In addition, Tax Law § 686(e) provides statutory authority for applying the overpayment of income tax in one year to the succeeding year as follows:

Credits against estimated tax.-The tax commission⁴ may prescribe regulations providing for the crediting against the estimated income tax for any taxable year of the amount determined to be an overpayment of the income tax for a preceding taxable year. If any overpayment of income tax is so claimed as a credit against estimated tax for the succeeding taxable year, such amount shall be considered as a payment of the income tax for the succeeding taxable year, and no claim for credit or refund of such overpayment shall be allowed for the taxable year for which the overpayment arises.

G. The Division of Taxation has not prescribed any specific regulations concerning the crediting of an overpayment of income tax for a taxable year to a taxpayer's estimated income tax for a succeeding taxable year. However, the Division of Taxation has promulgated detailed regulations governing the due dates for estimated tax installments and for penalties or "additions to tax" to be imposed when such installments are not made timely (20 NYCRR 185.3). If an estimated tax installment is not made timely as required by statute, these regulations elaborate on how an "addition to tax" or penalty is to be calculated based on such failure.

H. As noted in paragraph "7", petitioners contend that the above due dates for estimated tax installments are not applicable to an overpayment from a prior year to be credited to an estimated tax account. The Division disagrees, and its position is reasonable given the statutory due dates for making estimated tax installments. In the matter at hand, petitioners' 1996 tax return was not filed until January 20, 1999, and pursuant to the due dates set forth in Tax Law

⁴ Effective September 1, 1987, under Tax Law § 2026, references to the State Tax Commission in the Tax Law, in all instances other than in relation to the administration of the administrative hearing process, are deemed to refer to the Division of Taxation or Commissioner of Taxation and Finance.

§ 685(c)(1), the fourth and final estimated tax installment for 1996 was due January 15, 1997, approximately two years earlier. Consequently, the Division's *refusal* to apply petitioners' overpayment of \$40,864.22 to petitioner's 1997 estimated tax account was reasonable.

Petitioners have not established that their interpretation of Tax Law § 686(e), which would ignore the due dates set forth in Tax Law § 685(c)(1), is the only reasonable interpretation or that the Division's is unreasonable (*see, Matter of Moerdler*, Tax Appeals Tribunal, April 26, 2001, *confirmed* 298 AD2d 778, 750 NYS2d 329). Moreover, petitioners' contention that an estimated tax payment is distinct from an overpayment from a prior year to be credited to an estimated tax account is rejected. The crediting of such overpayment to an estimated tax account is so similar to an estimated tax payment in effect that any attempt to distinguish the two is mere hairsplitting.

I. Although the Division's *refusal* to apply petitioners' overpayment of 1996 income tax to 1997 was reasonable, it nonetheless is concluded that petitioners' failure to timely *pay* was due to reasonable cause and not due to willful neglect. In other years, the Division has applied an overpayment of one year's income tax to the succeeding year regardless of petitioners' late filing of a tax return, and, as noted in Finding of Fact "4", petitioners have avoided the imposition of penalties. Given such background, it was reasonable for petitioners to anticipate that for the year at issue, the Division would act similarly. Consequently, penalty for late payment is properly canceled.

J. In contrast, petitioners have not established that their failure to timely file their tax return was due to reasonable cause and not due to willful neglect. Rather, petitioners have made a conscious decision to file late income tax returns. For the year under review, the strategy, to overpay tax ultimately to be reported due, failed because the Division refunded the

underpayment for the preceding year and petitioners *cash*ed the refund check. Petitioners may be correct that if they had returned the refund check for 1996 instead, they would have avoided the imposition of any penalties, other than the potential for the mere penalty of \$100.00 as detailed in Conclusion of Law “B”. Nonetheless, petitioners’ bold complaint that the Division should have advised them of their ability to return the refund check is without merit; it simply was not for the Division to advise petitioners how to avoid financial consequences as a result of their failure to file a timely income tax return *as mandated by law* (Tax Law § 651, which is detailed in Conclusion of Law “A”).

K. The petition of Phillip F. and Judy Kauffman Goldstein is granted to the extent indicated in Conclusion of Law “I”, the Notice and Demand dated October 19, 2001 is to be modified to so conform, and petitioners’ claim for refund dated April 15, 2002 is granted in part.

DATED: Troy, New York
July 22, 2004

/s/ Frank W. Barrie
ADMINISTRATIVE LAW JUDGE